30 NOV 1960

MEMORANDUM FOR: Deputy Director/Intelligence

SUBJECT: Western Problems in Marketing Petroleum

REFERENCES: (a) Memorandum for the DCI from Chief of Naval Operations, dated 19 November 1960
(b) Enclosure to Reference (a), entitled, "Growing Crisis in the Distribution and Marketing of Petroleum by Western Nations"

1. A critique of Reference (b) is enclosed for possible inclusion in the Director's response to Admiral Burke's letter.

2. In Reference (a), Admiral Burke appears to look upon Soviet oil sales in Western markets as little more than moves in the cold war and as "economic warfare". He suggests that a study be undertaken by interested agencies of the Government working in conjunction with the petroleum industry. Although it is not clear what kind of a study he has in mind, it would apparently cover a very broad range of problems including US policy toward what is called Soviet economic warfare. We feel strongly that if such a study is undertaken, it should be preceded by an intelligence study of Bloc capabilities and intentions with respect to the export of oil over the next five years or so. Before a prudent US policy can be developed, it will surely be necessary to secure a common understanding of Soviet capabilities for export, and even more important, of what the Soviets are up to. An intelligence study would also support the US representative to the NATO ad hoc study group on Soviet oil policy. Finally, it would help to pin down the varied and often contradictory figures which are quoted on Soviet oil sales abroad. We had concluded even before receipt of the references that an intelligence study would be desirable and are prepared to go ahead with it. Our present views are very briefly stated in the draft of NIE 30-60, Middle East Oil, now before the USIB representatives.

3. Referenced documents contain many of the ideas expressed by M. J. Rathbone, President of the Standard Oil Company (New Jersey), at a recent convention of the American Petroleum Institute. We understand that Mr. Rathbone and others have expressed similar views to various government officials. Mr. Rathbone is reported to have told the API convention that Western governments should make representations that oil deals with the USSR are not a good idea and to have added that

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although other governments have recently protested through diplomatic channels, the US has not.

4. Many US oil companies are apparently greatly concerned about the recent agreement between the Soviet Union and ENI of Italy. ENI has for a number of years carried on a feud with the Western international oil companies. It was Enrico Mattei, head of ENI, who first broke the traditional pattern of 50-50 agreements with Middle Eastern countries, when he negotiated a 40-60 deal with Iran in 1955. Among his other grievances, fancied or real, Mr. Mattei blames the US oil companies for keeping ENI out of Libya. It is just possible that the US oil companies consider Mattei to be as great a villain in the Italian deal as the Soviets, if not a greater one.

25X1

[redacted]

OTTO E. GUTHE
Assistant Director
Research and Reports

Attachment

CENTRAL INTELLIGENCE AGENCY
WASHINGTON 25, D. C.

OFFICE OF THE DIRECTOR

Admiral Arleigh Burke
Chief of Naval Operations
Department of the Navy
Washington 25, D. C.

Dear Arleigh:

Thank you for your letter of 19 November enclosing the study "Growing Crisis in the Distribution and Marketing of Petroleum by Western Nations."

I have had some of my people review the study carefully and they prepared comments for me which you may find of interest. I am enclosing a copy for you.

I feel that an intelligence study of Bloc capabilities and intentions with respect to the export of oil over the next five years or so should precede any over-all policy study, and we are prepared to undertake such a study in the near future.

[redacted] 25X1

Allen W. Dulles
Director

Enclosure

COMMENTS ON STUDY ENTITLED "GROWING CRISIS IN THE DISTRIBUTION AND MARKETING OF PETROLEUM BY WESTERN NATIONS", DATED 19 NOVEMBER 1960

The theme of this study concerns Soviet objectives in the international oil market and the effect of Soviet actions on the national security interests of the United States.

This study states that cost considerations are secondary to political motivations when the USSR tries to penetrate Western oil markets. It is believed that this interpretation oversimplifies the present situation and wrongly states the probable Soviet motivation. The fact is that the Soviets have become large producers of petroleum and that they possess a surplus over their own requirements and the import requirements of the other Communist countries. While economic considerations may well be secondary to political considerations in sales to underdeveloped countries, the reverse is almost certainly true in the developed countries of Western Europe, which account for the bulk of present day Western oil markets outside the United States. It is believed that the principal objective of the Soviet Union in Western Europe is to sell oil as a source of foreign exchange to pay for increased imports of plant equipment needed to achieve the production goals of the Seven Year Plan, and that the Soviet interest is in maximizing earnings rather than in conducting an economic cold war. Past Soviet policies in the tin and diamond markets tend to support this interpretation, for when the Soviets had secured what they considered a fair share of the market, they were perfectly willing and even eager to sell at going prices. At the present time, oil is the largest single earner of foreign exchange for the USSR.

Present Soviet pricing policy is best understood in terms of the economics of the international oil market, not in terms of economic warfare. Oil is a homogeneous commodity usually purchased in relatively large quantities by well informed buyers. Although buyers are interested in such things as continuity of supply, product quality, and the like, they are even more strongly interested in relative price. Western purchasers would almost certainly not buy from the Soviet Union if Soviet prices, quality and terms of trade were the same as those offered by the Western oil companies. Therefore, and because the quality of Soviet oil is in fact inferior, the Soviets are under strong economic pressure, particularly when first entering a market, to better Western offers by cutting prices, accepting local currencies, bartering and the like. They certainly could not significantly enlarge their share of the market without the use of such tactics, particularly at the present time, when oil supplies are plentiful.

The study states that the problem from the point of view of United States national security interests is not simply that the Western

companies lose markets or that the United States balance of payments suffers. It then cites two problems. The first is that the Soviets can influence the price of oil by dumping or price cutting operations. It has already been noted that in the important markets at least, the Soviets are probably not interested in doing these things per se. In the present context, it also is questionable whether Soviet price cutting is necessarily contrary to the security interests of the United States, as distinct from the commercial interests of the oil companies. The second problem is said to be that the Communist states create a picture of "bettering" Western private enterprise in competitive markets, and that this will serve "as an example of the Soviet system winning out over the American system". If hitherto friendly or neutral nations reached such a conclusion, the national security interests of the United States would indeed be affected. It remains to be demonstrated, however, that the Soviet Union would always "better" private enterprise in selling oil, or that other nations would, as a result, reach the above conclusion. It also does not follow that consumer nations will "turn a more attentive ear toward Communist overtures lest their vital oil supply line be tampered with by the Kremlin", because alternative sources would be readily available in the West.

It is stated in the study that the recent Soviet-Italian agreement indicates a price for Soviet oil of one dollar per barrel, which is said to be below the actual cost of production of Middle East operators. The study also refers to the "ridiculously low prices" set by the Soviet Union for its oil. Although production costs for Middle East oil are not available from authoritative sources, it would be surprising if these costs were not substantially below one dollar per barrel, and perhaps as little as fifty cents or less. Judgment on whether or not the Italian deal was "commercial" should be based on an examination of the details (including prices) on the products which the USSR is receiving from Italy, including large diameter pipe, valves, rubber, etc.

30 November 1960

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TO	NAME AND ADDRESS	INITIALS	DATE
1	DD/I	RAJ	12/1/60
2	DCI		
3			
4			
5			
6			

	ACTION		DIRECT REPLY		PREPARE REPLY
	APPROVAL		DISPATCH		RECOMMENDATION
	COMMENT		FILE		RETURN
	CONCURRENCE		INFORMATION		SIGNATURE

Remarks:

Bob:

The Director read the attached with a great deal of interest and asked for your recommendations together with a proposed reply for his signature to Admiral Burke.

JSE

Enclosed are ORR's comments. They didn't think much of Adm Burke's study. As you know he sent similar letters to virtually everyone in the NSC. I don't advise getting in an argument with him but if you want to respond here is letter and memo to [illegible]

RAJ

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FROM: NAME, ADDRESS AND PHONE NO.	DATE
EO/DC [redacted] blp [redacted]	23 Nov 60

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(40)

FORM NO. 237 Replaces Form 30-4 which may be used.
1 APR 55

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TO	NAME AND ADDRESS	INITIALS	DATE
1	DD/I - Mr. Amory	RE,Jr/ms	DEC 6 1960
2	[redacted] - for reply		
3			
4			
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	ACTION		DIRECT REPLY		PREPARE REPLY
	APPROVAL		DISPATCH		RECOMMENDATION
	COMMENT		FILE		RETURN
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Remarks:

Bob:

After signing the attached letter, the boss had second thoughts and commented that the enclosure would only tend to irritate Admiral Burke. He has therefore asked that our letter be rewritten along the lines of Gordon Gray's reply (attached), advising what we are doing and also offer to put our people in touch with his experts on this matter.

JSE

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FROM: NAME, ADDRESS AND PHONE NO.	DATE
EO/DCI [redacted]	3 Dec 60

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